



January 30, 2006

Stephanie Hillmon, Esquire
Assistant General Counsel
The Committee for Purchase From People Who Are Blind or Severely Disabled
1421 Jefferson Davis Highway
Suite 10800
Arlington, VA 22202-3259

Re: Nonprofit Agency Governance and Executive Compensation

Dear Ms. Hillmon:

Goodwill Industries of Southeastern Wisconsin, Inc. ("Goodwill") submits these comments in response to the advanced notice of proposed rulemaking, request for comments, and notice of public hearings published December 16, 2005 (the "Notice") by the Committee for Purchase from People Who Are Blind or Severely Disabled (the "Committee"). Goodwill previously responded to the notice of proposed rulemaking published by the Committee in November 2004.¹

As a major provider of services to individuals with severe disabilities under the JWOD program, Goodwill has a special interest in the Committee's initiative on corporate governance and executive compensation. Our Goodwill is one of over 200 autonomous organizations that make up the Goodwill network. Our mission is to provide work opportunities and skill development for individuals with disabilities and other barriers to employment. Our territory covers 23 counties in Southeastern Wisconsin and Metropolitan Chicago. In pursuit of our mission, we employ over 3,000 individuals pursuing a diverse set of activities, including retail stores and donation centers, government-funded human service programs, commercial services for private companies, and services for government agencies.

Under the JWOD program, through contracts with the United States Navy, Goodwill currently employs over 800 individuals with severe disabilities. These employees provide a wide range of services at the Naval Station Great Lakes in Great Lakes, Illinois, including food services, administrative services, logistics services, and other functions. Since we filed comments with the Committee in February 2005, Goodwill Great Lakes has won several additional honors, including 2005 Employer of the Year from the Haymarket Center Chicago,

¹ See Comments of Goodwill Industries of Southeastern Wisconsin, Inc., December 13, 2004 and February 9, 2005.

6055 N. 91st Street
Milwaukee, Wisconsin 53225
(414) 353-6400
fax: (414) 353-2510

American Legion Department of Illinois, and American Legion (National). More recently, Goodwill has contracted with the Veterans Administration through NISH to provide laundry services to the Edward Hines, Jr. VA Hospital in Hines, Illinois and the Jessie Brown VA Medical Center in Chicago, Illinois. By contracting with Goodwill, our federal government customers have received excellent service at a competitive price, while generating high-quality jobs and opportunities for advancement for our employees with severe disabilities.

We share the Committee's objective that nonprofit agencies qualifying for the JWOD program adhere to appropriate governance practices, thereby ensuring the integrity of the program. The issue is how the Committee should pursue this goal, without imposing restrictions that would impair the ultimate goal of promoting employment opportunities for individuals with severe disabilities. We applaud the Committee's decision to withdraw its earlier proposal, and we appreciate the opportunity to provide input on the questions raised by the Committee in the recent notice.

In these comments, we **first** discuss developments that have occurred since the Committee's original notice in November 2004. As we predicted in our earlier comments, the regulatory bodies responsible for overseeing nonprofit agencies have moved with dispatch to address major issues of concern. Clearly the Committee is not the only group that recognizes that remedial action was necessary to correct certain abuses by charitable entities. **Second**, we address the Committee's question whether its list of best practices is the correct one or whether some practices have been excluded. **Third**, we discuss the approach of relying on a third party accreditation organization to determine qualification of JWOD agencies. We believe this would be the most effective way of balancing the need for accountability against the desire to avoid unwarranted intrusion into how agencies manage their business. **Fourth**, we comment on the issue of executive compensation and its relationship to fair market price. The benchmark for all regulatory oversight, in our view, should continue to be whether the proposals will promote the goal of the JWOD program to increase the employment of individuals with severe disabilities, or rather will hinder that objective.

1. Nonprofit Agencies Are Already Improving Their Management Practices in Response to Greater Regulation and Public Scrutiny.

The Notice states that the Committee is not interested in receiving comments regarding its authority to issue regulations in the area of corporate governance and executive compensation, or regarding whether those regulations might be redundant in view of the role of other executive agencies. As a condition to issuing new regulations, however, an explanation should be provided as to why the body of law that applies to nonprofit organizations generally is not sufficient to ensure good management by JWOD agencies. At a minimum, the Committee should address what is unique about the JWOD program, such that it dictates rules for corporate governance and executive compensation that are stricter than those covering all nonprofit organizations. Like the notice issued in November 2004, the most recent Notice is silent on this topic.

Such an explanation is especially warranted in light of the flurry of regulatory activity in the last eighteen months that has significantly increased accountability of nonprofit organizations. To cite some examples:

- The Panel on the Nonprofit Sector (the “Panel”) presented its Final Report to Congress in June 2005 (the “Panel Report”). The Panel Report was the culmination of a project that included representatives of hundreds of nonprofit corporations of all sizes and from across many industries. After sifting through a huge amount of testimony and expert advice, the Panel developed a comprehensive set of recommendations on a spectrum of regulatory issues, including corporate governance and executive compensation. The Panel was careful to distinguish those recommendations representing best practices that charities could voluntarily elect to pursue; those recommendations that were appropriate for adoption by the IRS; and those that required legislative change by Congress. The result is an integrated proposal, with more than 120 specific recommendations, that carefully calibrates government oversight and self-regulation as the best method to enhance accountability.
- The Panel Report gave further impetus to reform efforts. The Senate passed the Tax Relief Act of 2005 (S. 2020), which incorporates a number of significant reforms directed toward charitable organizations, including recommendations by the Panel. For example, the legislation increases the excise taxes arising from participation in excess benefit transactions by managers of public charities and social welfare organizations.
- The IRS continues to move forward with its Tax-Exempt Compensation Enforcement initiative. The Exempt Compensation Enforcement Unit mailed approximately 1,250 compliance check letters in fiscal year 2005. The number of charitable organizations that have been contacted to respond to questions regarding compensation now approaches 2,000. The IRS has begun a “significant number” of field examinations and this program will be a priority in the current fiscal year, according to the agency’s implementing guidelines. After completion of these examinations, the IRS will report on the results and will conduct more examinations and checks for compliance. The agency is backing up its words with resources; the budget for exempt organizations examination rose 23 percent in fiscal year 2005 over the previous year.²
- The Internal Revenue Service has proposed changes in the Form 990 that will tighten the requirements for disclosure of officer compensation, making such information more widely accessible.
- The State of California enacted the California Nonprofit Integrity Act, which took effect January 1, 2005. That legislation requires nonprofit organizations with revenues over \$2 million per year to produce audited financial statements, under

² See B. Hopkins, Nonprofit Counsel, vol. 23, no. 2, pp. 3, 8 (February 2006).

the oversight of an audit committee. The law has a detailed prescription of how the committee should be composed and how it should conduct business.

Meanwhile, the media continue to highlight instances of alleged excessive compensation by nonprofit organizations. Third party watchdog groups continue to develop their storehouses of information on charitable organizations, and they are gaining in popularity. And the 2005 National Board Governance Survey for Not-for-Profit Organizations, prepared annually by Grant Thornton LLP, shows that an increasing number of nonprofits are implementing some of the best practices embodied in the Sarbanes-Oxley Act; 65 percent of nonprofit organizations surveyed indicate they have made changes in corporate governance policy in response to the Act, more than triple the 20 percent that reported changes back in 2003.

Like other nonprofit organizations, most JWOD agencies are following these developments and reviewing their governance practices to respond to heightened expectations for transparency and accountability. Any new regulatory initiative by the Committee should include a discussion of why those efforts are not sufficient to ensure the integrity of the JWOD program.

2. The Committee Should Not Enter the Business of Evaluating or Requiring Specific Corporate Governance Practices.

The Notice makes no mention of any of these recent important regulatory developments. Rather, the Notice asserts that “qualified agencies have good governance practices” and proceeds to identify fourteen factors as “representative” of best practices but “not all-inclusive.” Later the Committee asks whether commenters believe that these criteria are, in fact, “comprehensive and inclusive” enough to effectively evaluate that a nonprofit agency demonstrates “good governance.” The Committee goes on to request commenters to suggest other criteria that may be added to, or substituted for, the ones identified, as supportive of good governance practices.

We respectfully suggest that the Committee should not enter the business of identifying which governance practices constitute best practices and therefore should be required of all JWOD agencies. The list of fourteen factors appears to have been chosen in cut-and-paste fashion from other standard-setting organizations. As the work of the Panel on the Nonprofit Sector has shown, however, these are not simple matters. These topics do not fall within the expertise of the Committee or its staff, and they do not represent an appropriate use of its staff time or other resources.

For example, the Committee recommends that the bylaws of a qualifying JWOD agency should set forth term limits for the service of board members.³ Goodwill Industries of Southeastern Wisconsin, Inc. currently adheres to all of the best practices identified by the Committee, with the exception of the recommendation for term limits. There is a debate in the corporate community whether such limits help or hurt the ability of charitable organizations to

³ This requirement appears to have been copied from “Standards for Excellence: An Ethics and Accountability Code for the Nonprofit Sector,” by the Standards for Excellence Institute.

fulfill their mission. At Goodwill, we believe that the most effective board includes a mix of individuals who are new to the organization -- and who can be expected to raise questions and challenge accepted ways of thinking -- and those with longer tenure, who are thoroughly familiar with the organization's culture and history, and who can place current issues in context. Moreover, turnover requirements would significantly increase the number of board members who must be identified and successfully recruited, at a time when many community leaders are limiting, not expanding, their involvement in nonprofit organizations. Although we believe that to allow indefinite tenure by board members is the best approach for our Goodwill, we recognize that other nonprofit groups have a different view and have decided that term limits will help them promote their mission more effectively. Such choices should remain in the hands of the management of each agency, and should not be dictated by the Committee.

A review of the pros and cons of the other governance practices is difficult because the Notice offers no explanation of why these factors were chosen and not others. For example, a major indicator of strong corporate governance is the scheduling of frequent board meetings. Some standards-setting groups suggest that a board of directors should meet a minimum of four times per year to assure it is effectively meeting its responsibilities. Yet the Committee does not include this factor in its list of best practices. Also, there is no reference to the need to keep appropriate minutes. Would a board of directors with five members that meets once a year and keeps no minutes, represent better governance than a board with three members that meets six times a year and dutifully records its activities? We believe no, but that result is implied by the selection of this particular combination of "best practices."

We do not mean to suggest that the Committee should revise its list of best practices to come up with a better list. The point is that it would be better policy for the Committee to avoid this exercise altogether. The essence of best practices is that the standard of what is the "best" constantly evolves. Whatever the merits of the fourteen factors identified here, others will be identified in the future. Unless the Committee intends to embark on a long-term initiative of constantly scanning the environment for the latest best practice, this will be a never-ending job. Otherwise, the fourteen factors will harden and cause a "race to the bottom," so that nonprofit organizations will have little incentive to go beyond the bare minimum requirements. It would be more appropriate for the Committee to defer to expert regulatory authorities in areas that are within their purview. As the bar is raised for what is considered appropriate corporate conduct for all nonprofit organizations, JWOD agencies will have no choice but to follow.

3. Accreditation Could Be an Appropriate Way To Increase Accountability of Qualifying JWOD Agencies.

The Committee also asks whether accreditation by state or national organizations should be recognized as evidence of a nonprofit adhering to good governance practices without review by the Committee. There has been discussion at the hearings whether accreditation by CARF, the Commission on Accreditation of Rehabilitation Facilities, could serve this purpose. Goodwill has programs that are accredited by CARF and we are very familiar with this organization and its processes. We agree with those commenters who have said that it would be

far preferable for the Committee to rely on CARF to certify compliance with governance standards than for the Committee to undertake this effort on its own.

If the Committee were to turn to CARF for assistance in monitoring JWOD agencies, however, it should become familiar with some of the unique features of this process and should consider how it should be tailored to meet the needs of the overseers of the JWOD program. To cite some examples:

- CARF accredits particular services or programs, not organizations. Although elements of governance and overall business practices are considered as part of the accreditation process, accreditation of one program does not mean that the organization is accredited for all of its programs. It is unclear whether the Committee is suggesting that accreditation for any program would be sufficient evidence of good governance practices, or whether the Committee would require each agency's JWOD program to be separately accredited.
- If the Committee's intent is to require accreditation of the JWOD program, it is hard to see how this could be established as a requirement for qualification of a JWOD agency. In order to be accredited, the programs must be up and running. Yet an agency has to be qualified by the Committee before it receives any JWOD contracts. Indeed, we understand that about two-thirds of the agencies that have qualified as JWOD agencies do not currently have JWOD contracts. Not only would an accreditation requirement add undue cost and burden to the process of qualifying as a JWOD agency, but there would be literally nothing to accredit prior to an agency receiving a contract award.
- If the Committee is suggesting that accreditation for any program by CARF would suffice for purposes of the JWOD program, one must ask whether that will promote the Committee's stated purpose of improving governance standards. CARF includes a review of business practices, and requires the agency to demonstrate systems in place for ensuring legal and regulatory compliance, but it does not require specific governance policies along the lines of the fourteen factors proposed by the Committee. Standards presumably would have to be added and clarified, or perhaps a separate set of standards would be developed by CARF for the purpose of evaluating governance of JWOD agencies.

4. Executive Compensation Does Not Affect the Determination of Fair Market Price.

The Notice takes a "second bite at the apple" with respect to the issue of executive compensation. In the November 2004 Notice, the Committee posited that excessive compensation undermines the integrity of, and public confidence in, the JWOD program, and the proposal was that compensation above a certain level would be presumed unreasonable. In the more recent Notice, the Committee approaches the issue from a different direction, and invites a discussion on the relationship between executive compensation and the fair market price determination. Its questions suggest an underlying assumption that at a certain level, executive

compensation will influence the fair market price for products or services provided under a JWOD contract.

We respectfully submit that this assumption is flawed. The fair market price is based on the market – that is, on what other customers are willing to pay for a product or service. It is not based on the costs of the agency providing the service, including executive compensation. By way of analogy, the fact that Bill Gates has earned extraordinary wealth through his role in Microsoft has no effect on the price that company is able to charge for its software; those prices are dictated by market demand, not by the costs incurred by the supplier.

It may be that the Committee has introduced the notion of compensation as possibly affecting fair market price, because otherwise there would be no jurisdictional “peg” on which to hang possible Committee action. But the interest of JWOD agencies in ensuring the reasonableness of executive compensation is no different in kind or degree from that of any other nonprofit organization. For that reason, if the Committee goes down this path it must by necessity begin to copy concepts and definitions from the IRS, because that agency is the source of that body of law. The Notice, for example, incorporates wholesale the standard of a “rebuttable presumption of reasonableness.” If that were to become a requirement, the presumption would have been turned on its head, from an option available to a nonprofit agency, to a minimum criterion for qualification. This shows, yet again, the problems that would be raised if the Committee were to select a handful of random concepts from other areas of administrative law, and use them to form the foundation for a new regulatory program, which does no more than duplicate the oversight of other agencies.

Conclusion

Goodwill greatly appreciates the opportunity to provide input to the Committee in response to the Notice. As indicated in our earlier comments, we continue to believe that there is no need for Committee action in the areas of corporate governance and executive compensation. Standards are continually being raised for all nonprofit entities, and JWOD agencies will necessarily follow suit. If the Committee does decide action is necessary, however, we believe that an accreditation process through CARF would be the best outcome. Such an approach would have to be tailored to the unique requirements of the JWOD program.

Very truly yours,

Terrence J. Leahy
Senior Vice President and General Counsel